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REPORT

A Two-Part Report: A and B

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JAPAN'S ROLE IN MULTILATERAL AID ORGANIZATIONS

Summary

As Japan's economic stature continues to grow, so too do its contributions to multilateral aid agencies. Tokyo has been steadily increasing its financial assistance to these organizations but has been content to take a back seat to Washington in formulating policies. Despite its low profile, however, Tokyo has begun to demand some recognition for its financial commitments -- primarily in the form of increased voting power in the multilateral banks. The United States has thus far been unwilling to relinquish its influence in these organizations. This report will explore Japan's role in the multilateral aid agencies, the pressures on Tokyo to expand its financial and political influence, and the effect of these multilateral policies on the U.S.-Japan relationship.

Introduction

Japan's global economic influence has fueled foreign demands that Tokyo shoulder more of the responsibility for international stability. While U.S. burden-sharing demands are familiar to Japanese officials, there is a growing clamor from the developing countries for more assistance to enhance their economic wellbeing. Tokyo, for its part, is quite willing to acknowledge the "international responsibilities of a surplus nation" and has consistently pledged to play a more active role in this area.

The question is how -- and how much? Tokyo has three major options. First, significant increases in defense spending, including contributions to U.S. military support in Asia. Officials argue that although efforts are being made on this score, they are limited by public opinion, constitutional con-

straints and the concerns of other Asian countries over any substantial military buildup by Japan (see JEI Report No. 19A, May 13, 1988). Second, Japan could help stabilize the international economy by embracing a number of trade liberalization schemes. The appreciation of the yen has helped somewhat in this regard, having spurred the Japanese market for foreign imports. But again, although Tokyo continues to participate in bilateral and multilateral trade negotiations, the domestic political ramifications involved make moderation the preferred course -- especially in very sensitive sectors such as agriculture.

The third option is economic development assistance for third world countries. This is the principal option that Tokyo has chosen. By assisting the development goals of these countries Japan also helps to achieve conditions that benefit the economies of the industrialized countries: expanded markets, an improved investment climate, the increased likelihood that debtor countries will meet at least some of their obligations and -- by extension -- greater political stability for regimes that promote market-oriented solutions. To these ends Japan has been steadily increasing its official development assistance and has made a number of efforts to stimulate Japanese private sector initiatives in less developed countries.

The spotlight on Japan's efforts has led to questions regarding the best way to achieve these goals. Both Tokyo and Washington would argue that in an ideal world the problems would be solved exclusively by private sector initiatives. In fact, however, the private sector is reluctant to expose itself further to the risks of political instability, nationalization and debtor defaults. Thus attention is focused primarily on government efforts.

Bilateral or Multilateral Aid?

Should Japan channel its financial contributions into bilateral or multilateral economic assistance? Each has advantages. The major attraction of bilateral aid is the control that Japan retains over disbursements. Aid becomes a valuable political tool -- one that Japan has used very effectively in Asia. Moreover, bilateral aid can be disbursed more quickly and more flexibly since it escapes some of the built-in red tape of the multilateral lending agencies.

The list outlining the advantages of multilateral assistance is longer. For one thing the political value of bilateral aid is a mixed blessing. From a purely economic standpoint, mixing politics and aid does not provide an optimal distribution of aid monies. What is more politically relevant, however, is that multilateral aid is less vulnerable to criticism from other countries and that contributions to multilateral organizations, which are a reflection of international economic strength, lend a certain prestige to the donor nation. Indeed, the Ministry of Foreign Affairs has lauded the "neutrality" of multilateral assistance, noting that "it makes recipient countries less apprehensive about [being subject to] a specific country's influence."

The ministry is also convinced that multilateral assistance is more likely to result in policy reform than Japan's bilateral aid. Although Tokyo

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supports the linkage between policy reform and aid, the structure of its bilateral program makes it nearly impossible to inisist on this linkage. Japan's aid program has a number of built-in safeguards to protect the sovereignty of the recipient country. The most effective of these is the "request-only" policy, which stipulates that all aid projects must be requested by the recipient government; Japanese aid officials cannot prescribe the specific use of the aid funds (see JEI Report No. 41A, October 30, 1987).

Moreover, the ministry acknowledges that international organizations often have better access to information and more expertise than individual governments. This is an important consideration since Japan has few experts who are knowledgeable about Latin America, sub-Saharan Africa and the Middle East. This poses a major problem for Tokyo; although it has pledged to improve the geographic distribution of its aid flows -- roughly 65 percent of total aid goes to Asia -- it lacks the facilities and personnel in other regions to do so effectively. Multilateral organizations, on the other hand, have the expertise and the resources to handle larger and more complex projects than an individual donor country.

able 1

DAC Members' Multilateral ODA Contributions

	Percent of ODA 1985-86 average		Percent of GNP 1985-86 average		Percent of DAC multilateral ODA 1985-86 average
Australia	30.3%		0.14%		3.0%
Austria	29.1		0.08		0.9
Belgium	19.8	(35.5)	0.10	(0.18)	1.3
Canada	38.3		0.19		8.6
Denmark	41.2	(47.9)	0.35	(0.41)	3.1
Finland	39.7		0.17		1.4
France	10.8	(18.4)	0.08	(0.14)	6.6
Germany	18.8	(31.7)	0.08	(0.14)	8.6
Ireland	25.5	(56.9)	0.07	(0.15)	0.2
Italy	23.6	(35.2)	0.08	(0.12)	5.6
Japan	32.1		0.09		20.4
Netherlands	24.3	(32.5)	0.24	(0.31)	4.7
New Zealand	20.3		0.06		0.2
Norway	41.1		0.46		3.8
Sweden	29.7		0.25		3.9
Switzerland	23.8		0.07		1.1
United Kingdom	23.4	(42.6)	0.08	(0.14)	5.2
United States	16.8		0.04		21.4
Total DAC	22.5	(27.2)	0.08	(0.10)	100.0

Note: Figures in parentheses include contributions from the European Economic Community.

Source: Organization for Economic Cooperation and Development, Development Cooperation, 1987 Report (Table IX-5). Reprinted with permission.

Japan's Contributions to Multilateral Aid Institutions

Partly for these reasons Japan's multilateral contributions as a percentage of total ODA have been higher than the average among members of the Development Assistance Committee of the Organization for Economic Cooperation and Development. (Multilateral aid takes two major forms: grants from Tokyo to the United Nations and its related organizations; and grants and loans to international financial institutions such as the World Bank, International Monetary Fund and regional lending institutions.) Japan's 1985-86 average was 32.1 percent -- substantially above the 22.5 percent DAC average -- and lower only than the shares of Denmark, Norway, Finland and Canada (see Table 1 on previous page).

Japan's latest aid initative -- a three-year plan to recycle $30 billion of Japan's current account surplus to the developing world -- includes a healthy portion of multilateral assistance. The first $10 billion goes exclusively to multilateral aid institutions. The remaining $20 billion includes bilateral loans, private loans that are co-financed by the World Bank and additional contributions to multilateral organizations. A more detailed breakdown follows:

$10 Billion to Multilateral Development Institutions

$2.6 billion - FY 1988-90 subscriptions to the International Development Agency (the low-interest arm of the World Bank).

$3.6 billion - (3 billion in Special Drawing Rights) for the International Monetary Fund as a special facility to deal with unusually critical situations that require "financial support beyond the usual recourse."

$2 billion - Special fund for the World Bank: $200 million in grant money from Japan and $1.8 billion to be raised by the World Bank in Tokyo's capital market.

$1.3 billion - Funds for the Asian Development Foundation (a window of the Asian Development Bank).

$20 Billion Recycling Initiative

$8 billion - Further government contributions to multilateral lending agencies, including the World Bank, the Inter-American Development Bank, the Asian Development Bank and the African Development Bank.

$9 billion - Untied loans by the Overseas Economic Cooperation Fund, the Export-Import Bank of Japan and possibly private banks co-financed by the World Bank.

$3 billion - Export-Import Bank untied loans.

Approximately 60 percent of the funds are reserved for multilateral contributions. Some of this may be because Tokyo's aid program suffers from an image problem among other DAC countries. Many critics regard Japan's bilateral assistance as little more than a way for Japanese industry to win lucrative

contracts in the developing countries. Princeton University professor John Lewis summed up this view: "The Japanese bilateral program, to say the least, has not been among the more self-denying in [regard to satisfying commercial self-interests]."

Officially, Tokyo's record is quite good when it comes to tied aid. OECD statistics show that Japan's use of tied aid is lower than the United States'. But the structure of the aid program causes some problems. Because Tokyo requires detailed feasibility studies before it approves an aid project, the recipients often turn to Japanese businesses for help in designing the proposal. By the time the study is completed, its specifications often fit quite closely with the goods and services offered by Japanese firms, leading to charges that Tokyo endorses an informal tying of aid to economic procurement.

Foreign critics also collide with Tokyo on the type of projects chosen. In 1986 more than 45 percent of bilateral assistance was earmarked for capital-intensive projects in public utilities, industrial, mining and construction. The DAC singled Tokyo out for criticism on this score during its annual talks last December, pointing out that these types of projects often depend on foreign supplies of sophisticated equipment.

Tokyo's multilateral efforts do not completely escape attack. Critics charge that Japan exaggerates its contributions. They point out, for example, that the $10 billion portion was announced a year before the total package was unveiled. Similarly, they charge that the $2 billion that is to be raised in Japan's capital markets imposes no burden on Tokyo and should not be claimed as a bona fide "contribution." Nonetheless the attacks on multilateral aid are much less strident than those on bilateral programs. The tone is also quite different. Most foreign aid specialists seem quite satisfied with the effectiveness of multilateral donations; their only complaint is that Tokyo should do more.

Japan's Potential

Japan's aid program has enormous potential for expansion -- especially in the area of multilateral assistance. For one thing, Japan's financial resources are staggering, with a current account surplus of almost $87 billion in 1987. The sheer size of its surplus qualifies Japan as the most likely donor of funds for the third world. The most serious obstacle is that the surplus is in the private sector, while the government has been operating under tight financial constraints. This is one reason Tokyo has encouraged the private sector to cooperate with the World Bank in co-financing new developing country loans.

Expanded contributions to the multilateral agencies are a way for Tokyo to maintain a fair amount of international credibility, since bilateral initiatives tend to be regarded with more suspicion. But this poses a different problem for Japan. The size of a country's capital subscription to a multilateral lending institutions is reflected in its voting share. Any increase in one country's voting share necessarily implies a proportional cut in another donor's; in this case the most likely candidate for a decrease is the United States. Although Tokyo was given an increased vote in the World Bank recently, Washington has been extremely reluctant to concede its influence in the World Bank or any other lending institution.

Japan has been able to skirt the issue somewhat by establishing "special funds" in the global and regional lending banks, but it is not likely to be satisfied with this state of events for long. A nation's voting share is a mark of international prestige; Japanese aid officials are facing domestic pressure from the Diet to demand a more equitable distribution of power in exchange for increased financial commitments. Some government officials also want Tokyo to exert more influence over the allocation of multilateral aid funds. Ministry of Finance officials reportedly want to see more loans to India and China; the Foreign Affairs Ministry tends to have a more global view.

Political Leadership

At the same time there is a growing clamor for Japan to take a leadership role in the multilateral banks. The pressure is coming from a number of sources: other DAC countries, the international press, policy analysts, and Japanese internationalists -- especially in the aid community -- who are dissatisfied with Tokyo's reluctance to propose significant initiatives. Few specific suggestions have been made regarding the policies Japan should take; the general impression seems to be merely that Tokyo should do more. The glaring exception to this list is Washington, which is turning the screws in the opposition direction. U.S. officials are quite content with the status quo since the firm U.S.-Japan alliance in the banks allows Washington to retain its traditional political influence.

One suggestion that has cropped up repeatedly in the press is the appointment of a Japanese head of the International Monetary Fund or the World Bank. This appears unlikely at least for the immediate future, especially since there is little enthusiasm for the idea in Japan. According to the Journal of Commerce, Finance Minister Kiichi Miyazawa said in 1986 that there are no Japanese officials qualified for the job.

Perhaps a better way to describe the situation is that those Japanese who are qualified for the job are not likely to accept. For government officials there is more opportunity for professional advancement at home; for businessmen, long-term prospects for success are brighter if they remain with their companies. Traditionally, Tokyo has been quite content to follow Washington's politicial lead in matters relating to development and its participation in the development instititutions has been a way of emphasizing U.S.-Japan policy coordination and soothing other areas of conflict, such as trade disputes.

At first glance Tokyo's reluctance to assume a more vigorous leadership role appears at odds with its desire for a larger voting share in the lending institutions. But it is a question of prestige; assuming a greater share would not affect Japan's alliance with the U.S. on most policy issues. This is a great source of frustration to non-U.S. officials in the lending banks. One official, for example, complained that Japan has simply bought itself an important position in the World Bank. It would be more productive, he said, if Tokyo showed more interest in policymaking and was willing to actively oppose some U.S. positions.

For its part Japan has pledged to act in a manner consistent with its economic status and has proposed a few initiatives, although these have been

either noncontroversial or extremely general. The former are no threat to Washington's leadership; the latter leave ample room for U.S. input. Still, the fact that Tokyo has taken the first step is a positive development and may portend a more active leadership role in the future.

The World Bank and the International Monetary Fund

Japan's position in the World Bank is a classic example of its commanding financial presence and low-key policy approach. Its voting share -- second only to the United States' -- was increased in 1986 when Tokyo agreed to raise its contributions to the International Development Agency by some $350 million in return for an increase of 1.5 percentage points in voting power. The United States agreed to relinquish part of its 20 percent share on condition that it retain its veto power. Japan's total IDA contribution, $2.6 billion, is included in the $30 billion in aid discussed above.

Japan's position in the International Monetary Fund is not quite as powerful as in the World Bank. According to the Fund's 1986 annual report, Japan's voting share is 4.57 percent, putting it in fifth place after the United States, the United Kingdom, Germany and France. One official said that Japan has a more difficult time being heard in the IMF than in the World Bank and that this is illustrated by the fact that Tokyo ranks relatively lower in the size of its voting share.

Despite its low-profile approach, Tokyo has used the annual IBRD-IMF meetings as a forum to announce aid initiatives. The increase in Japan's IDA subscription was one example, as was the announcement of a $500 million grant package for the poorest developing countries, especially those in sub-Saharan Africa. The package was intended to complement the $20 billion recycling fund which is targeted at middle-income developing countries. In 1987 Tokyo suggested the establishment of a debt-equity conversion fund to be administered by the International Finance Corporation.

Tokyo again raised the debt problem at the April 1988 annual meetings. Finance Minister Kiichi Miyazawa rejected short-term solutions involving debt forgiveness or debt reduction, advocating instead a long-term perspective that would enable countries to embrace a cooperative solution. The details were kept vague; he merely asked that member countries study the problem and propose an appropriate initiative. U.S. cooperation would be necessary for such a plan to succeed, however, and Washington has thus far resisted the idea of a multilateral debt scheme.

But for the most part Japan supports U.S. policies, such as those linking multilateral disbursements to policy adjustments and reforms in the LDCs. According to the 1987 DAC Report, the "countries which, in recent statements of their general policy priorities and objectives, have given particular emphasis to policy reform include Canada, Germany, Japan, the Netherlands, the United Kingdom and the United States." As one would expect, the way that Tokyo has demonstrated its support for this concept is through financial contributions. The DAC points to Japan's multi-million-dollar contribution for a Special Facility for sub-Saharan Africa administered by the IDA.

Asian Development Bank

If there is one institution in which Japan has taken a dominant role it is the Asian Development Bank. Tokyo is the largest contributor and also holds the formal reins of power, since the president of the bank has traditionally been Japanese. But here, too, Tokyo is more than willing to see Washington play a strong co-leadership role. The U.S. substription and voting share is only slightly less than Japan's. Washington contributes 14.8 percent compared with Tokyo's 15 percent. Policymaking, therefore, has been shared fairly equally.

As Dennis Yasutomo points out in Japan and the Asian Development Bank, Tokyo has been plagued by an apparent contradiction regarding its image in the bank. One the one hand, it is the bank's nominal leader. Moreover, its relationship with Washington is more collaborative than concessional. On the other hand, Tokyo is reluctant to become too dominant, partly because it fears resurrecting memories of the wartime Greater East Asia Co-Prosperity Sphere in the developing countries and partly to preserve amicable relations with Washington, which wants to retain its influence.

Yasutomo quotes one Finance Ministry official on this question:

> Japan has been replacing the role the U.S. has been playing, but we don't want to be very dominant in the ADB. Among ASEAN [nations], India and Pakistan, there is a feeling that Japan is too dominant in the region. We want to be less conspicuous. We want the United States and Australia to join with us to be the three major forces. But because of U.S. unwillingness to shoulder the burden, we are forced to come up with [more] contributions.

One negative byproduct of this conflict -- combined with other obstacles such as language difficulties -- is that Japanese officials are reluctant to play an active political role within the ADB. This has resulted in a passivity and a tendency to allow other countries to have a disproportionate input in policy decisions.

Still, because Tokyo has been pumping more money into the ADB, officials are anxious to receive some recognition for their contributions. Consequently the question of voting shares and capital contributions has surfaced. Finance Ministry official Toyoo Gyohten said during the April 1988 annual meeting of the ADB that "Japan is ready to shoulder the responsibility as the largest financial contributor on condition that the United States agrees to the capital hike." Bank of Japan governor Satoshi Sumita argued that a steady flow of funds is necessary to counteract setbacks such as natural disasters, economic changes in developed countries and changing commodity prices. But U.S. officials have said that there will be no need to consider an increase until the early 1990s.

Tokyo claims that it deserves a larger voice on the basis of its financial contributions -- including a special fund set up specifically for the ADB under its $30 billion initiative. While several member countries agree, not all are convinced that a capital hike is the most relevant issue to discuss.

Swedish aid officials, for example, stress that discussions of a capital increase are meaningless if there is no consensus on the goals and policies of the bank. This issue is bound to become more prominent as U.S. financial constraints prompt Tokyo to assume an ever-larger financial presence.

The United Nations

In 1986 (see JEI Report No. 18A, May 9, 1986) Japan provided $75.9 million for the U.N.'s regular budget, the third-largest amount after the United States and the Soviet Union. Japan has been a top donor to several U.N. programs as well, including the World Health Organization, the United Nations Development Program, the World Food Program, the United Nations Children's Fund and the United Nations High Commissioner for Refugees (see Table 2).

Table 2

DAC Members' Shares in ODA, IDA and Selected Categories of U.N. Funding

(in percentages)

	ODA 1985-86	IDA-8	UNDP 1986-87	UNFPA & UNICEF 1986-87	Extra-Budgetary Contributions to UN Agencies 1985-86
Australia	2.3%	2.0%	1.1%	0.6%	1.7%
Austria	0.7	0.7	1.1	0.3	0.7
Belgium	1.5	1.7	2.1	0.5	3.9
Canada	5.1	4.9	6.4	5.4	2.1
Denmark	1.7	1.3	7.9	4.7	11.4
Finland	0.8	0.8	2.7	5.8	3.0
France	13.7	7.2	4.8	1.5	2.3
Germany	10.2	11.8	8.2	7.3	6.3
Ireland	0.2	0.1	0.2	0.2	---
Italy	5.1	6.0	6.4	7.4	14.7
Japan	14.1	22.3	8.8	14.4	8.2
Netherlands	4.3	4.3	8.9	8.1	12.6
New Zealand	0.2	0.1	0.2	0.2	---
Norway	2.1	1.4	7.9	10.6	9.3
Sweden	2.9	2.6	9.0	10.7	11.6
Switzerland	1.1	1.4	3.8	3.2	4.5
United Kingdom	5.0	6.7	4.3	4.6	2.1
United States	29.0	24.7	16.1	14.4	5.7
Total DAC	100.0	100.0	100.0	100.0	100.0

Note: ODA: Official Development Assistance
IDA-8: Eighth replenishment of the International Development Agency
UNDP: United Nations Development Program
UNFPA: United Nations Fund for Population Activities
UNICEF: United Nations Children's Fund

Source: Organization for Economic Cooperation and Development, Development Cooperation, 1987 (Table IX-6). Reprinted with permission.

The political circumstances in the United Nations are quite different from those in the multilateral banks. The General Assembly operates on a one-country, one-vote basis. This means that the industrialized countries are vastly outnumbered by the developing nations. North-South tensions have been extremely pronounced in the U.N. because the LDCs have the voting clout to push measures through the General Assembly. As a consequence, Tokyo has found it much more difficult to vote with the consensus in the U.N. While it has tended to support U.S. positions, Washington has been in the minority more often than not, forcing Tokyo to tread a fine line on North-South issues as it attempts to back U.S. positions without alienating the developing countries.

Japan has opted for a risk-averse strategy by maintaining a very low profile and espousing vague rather than clearly defined policies. While it has not made many enemies this way neither has it established a definitive leadership role. The Far Eastern Economic Review quoted one American official as explaining, "If your aim is to be a key player, then you have to act according to an international definition of a key player. Otherwise nobody takes you seriously." (Although a Japanese official was recently appointed director of the World Health Organization, this is an exception rather than the rule.) One of the most frustrating issues for Africans has been Tokyo's unwillingness to force Japanese business firms to further reduce the extent of their trade relations with South Africa (see JEI Report No. 7B, February 19, 1988). African nations resent Japan's policies on apartheid, and as a result Japan's relations with the region have suffered.

This has already begun to jeopardize Japan's position on the U.N. Security Council. Although it is not a permanent member, Japan has been elected to the Security Council as a temporary member more often than any other country. There are reports, however, that Tokyo is finding it more and more difficult to muster the requisite two-thirds majority for election. Many of the defectors are African nations. More generally, however, observers point to Tokyo's reluctance to take the lead in formulating positions and policy recommendations. In short -- as in other multilateral organizations -- Japan's financial stature outweighs its political leadership.

Development Assistance Committee

The Development Assistance Committee of the OECD is not a multilateral lending institution, but it is a forum that Japan takes very seriously. One of the standards by which various aspects of Japan's ODA contributions are measured is the DAC average. Aid as a percentage of GNP, for example, is an area in which Tokyo has not compared favorably with other donor countries. In 1986 the group averaged 0.36 percent, compared with Japan's 0.29 percent. When Japanese officials discuss aid goals they often refer to Tokyo's intention to raise its ODA/GNP ratio to at least the DAC average.

On the reverse side, the DAC recognizes Japan as one of the largest ODA donors. Tokyo's contributions have grown enormously in recent years, catapulting Japan to second place on the donor list. Furthermore, most observers are predicting that Tokyo will surpass the United States as the number-one donor in the next year or two. The growth of Japan's ODA program can be attributed to two major factors. First, Tokyo has made ODA a major priority and established a series of aid-doubling programs to stress the importance of steadily increasing its contributions (see JEI Report No. 41A, October 30, 1988). Second, the increase in the value of the yen has caused the dollar value of aid disbursements -- the currency used for DAC statistics -- to soar.

The DAC's annual reports praise Japan for the level of its overall aid commitments. Specifically with regard to multilateral aid, the 1986 report said that Tokyo has increased its contributions "to a degree which calls into question the traditional balance of influence, as reflected in voting rights and which resuscitates, in a new form, the thorny question of burden-sharing." The report highlighted the importance of a "second rank of donors" after the United States, referring to Canada, Germany and Japan. Although Germany and Japan have been less vocal in proposing initiatives, the report said, "the sheer size of their contributions inevitably gives considerable weight to whatever positions they take."

Conclusion

There is little doubt that Japan's role in the multilateral aid organizations will continue to grow in importance. In financial terms alone its participation is vital to the World Bank and the Asian Development Bank. Even non-Asian regional banks, such as the Inter-American Development Bank and the African Development Bank, rely on Japan as the second most important donor.

The future of Tokyo's political leadership is more doubtful. There has been little evidence of a willingness to take the lead in devising innovative multilateral responses to debt and development problems. Although the proposals announced at the IBRD/IMF annual meetings suggest some movement toward a leadership role, they are still too small to be significant.

Much of the reason for the inaction revolves around the United States. For one thing Washington is extremely unwilling to relinquish its overwhelming influence. In the World Bank, for example, the United States is the only member with veto power. Tokyo quite simply has no desire to challenge Washington on this score. Moreover, some World Bank officials believe that Japan views its role in multilateral organizations more as an extension of its relationship with Washington than in a global context. One official complained, "If [World Bank president] Barber Conable asked Tokyo to do something, the answer might be no. If [U.S. Treasury Secretary] James Baker made the same request, the answer would be yes."

While this might be an exaggeration, it is true that Tokyo's role in the multilateral institutions is intimately connected to its relationship with Washington. Still, the decline in the U.S. financial position relative to Japan gives the leadership question more urgency. The external pressures on Japan to increase its financial contributions are especially intense; it is here that the largest changes are likely in the near future. (Unless some accommodation is made in relative voting shares, however, funding will probably continue to take the form of "special facilities.") The pressures to take the lead in policymaking are more muted at this point -- Washington certainly has no desire to see such a change -- but still very real.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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Takeshita Faces Thorny Domestic, International Policy Issues

Prime Minister Noboru Takeshita returned home after a successful diplomatic foray in Europe to a host of domestic and international policy issues that are testing his political mettle. Heading the agenda is the highly contentious beef and citrus quota dispute with the United States. In the domestic policy area, Mr. Takeshita must also try and shepherd through the Diet a comprehensive tax reform bill. Finally, the prime minister has had to contend with the negative repercussions of a cabinet member's comments defending Japan's wartime activities in Asia. Although it is too soon to tell how his management of these issues will affect his tenure as prime minister, most would agree that Mr. Takeshita is at an important point in his administration and must effectively demonstrate that he has both the diplomatic skills and the political savvy to navigate Japan through rough waters.

The prime minister has said that he favors resolving the beef and citrus dispute through bilateral negotiations. After the April 27-May 3 talks stalled, Washington again asked the General Agreement on Tariffs and Trade to form a panel to rule on the legality of the quotas (see JEI Report No. 18B, May 6, 1988). Since it will probably take until early to mid-June for the GATT to

while the Koreans have expanded capacity by 240 percent in 12 years. While it would be reasonable for the EC to ask Japan to reduce its capacity to match the European cut, no specific numbers have been raised.

On April 23 Tokyo agreed to a five point accord: the two sides concur that the grave situation in world shipbuilding requires special attention; both governments will cooperate on the "common objective of urgently improving the market situation" with particular attention to restoring prices to profitable levels; regular meetings on implementation will be held; other shipbuilding countries, especially Korea and Finland, will be invited to join the talks; and Tokyo will gradually bring its export credits to shipbuilders in line with world levels.

The results may be moot in view of recent announcements that Japanese shipbuilders plan to merge operations and reduce capacity. Of the two dozen major firms, eight groups will remain at the end of this year, with capacity reductions ranging from 13 to 26 percent. According to Transport Ministry calculations, the capacity of these firms will drop from 3.1 million gross tons to 2.4 million gross tons by the end of fiscal 1988 (April 1, 1989). The key to the global market problem, however, is persuading Seoul to restrain growth -- an unlikely prospect.

• Access to public works projects - Just before Mr. Takeshita left for the continent, the EC issued a joint communique demanding that Tokyo give European construction firms the same consideration as U.S. firms in bidding on specific public works projects (see JEI Report No. 14B, April 8, 1988). The April 25 document reiterates the community's longstanding position calling for a "balance of benefits" in Japan-U.S.-EC relations and warns Tokyo and Washington that the EC will not hesitate to take action if the two discriminate against European companies. At the same time the community pledged to actively encourage domestic firms to pursue Japanese bids. The prime minister did not touch on this subject, but officials reiterated Tokyo's position that the special bidding procedures would be applied equally to all interested foreign firms.

• Modifications to the U.S.-Japan semiconductor accord - The last issue, modifying the U.S.-Japan semiconductor accord to comply with a ruling by the General Agreement on Tariffs and Trade, is in the midst of a negotiation hiatus. The initial round of talks between Tokyo, Washington and Geneva gave each side a chance to clarify its positions (see JEI Report No. 19B, May 13, 1988), but little else was achieved. Tokyo is hard at work trying to tread a narrow path between the U.S. and EC positions, and hopes to hold a second round of talks this summer. If the process holds true to form, Tokyo will find a formula that will keep trade issues from poisoning overall bilateral relations.

Jon Choy

Japanese Workers Win Bigger Paychecks

Although Japan's labor unions termed this year's annual spring wage negotiations (shunto) the "13th consecutive defeat" at the hands of management, unionized workers will take home paychecks that average 4.38 percent more, higher than last year's 3.5 percent increase. The unions' gloom reflects

dashed expectations of higher increases based on the economy's solid recovery from last year's high-yen "recession." Most analysts expect this year's gain in basic pay levels to support, not spur, consumer spending. Since the data are based on a mid-term survey, however, this picture may yet change.

According to an April 27 poll by Nihon Keizai Shimbun, workers at 1,310 companies won an average Y10,162 ($81.30 at Y125=$1.00) increase based on calculations adjusted for relative employment in each industry (see Table), bringing average base monthly compensation to Y231,750 ($1,854). Of the industries listed, it is interesting to note that only four show wage hikes below the 4.38 percent average. The impact of these industries on the overall average may be exaggerated, however, because they constitute a large share of the number of firms surveyed (47.3 percent). Indeed, when an average based only on the number of firms is calculated, the figure falls to 4.3 percent.

Mid-Term Results of the 1988 Spring Wage Negotiations

(as of April 27, in yen and percent)

Industry	1987 (Actual) Amount	1987 (Actual) Change	1988 Amount	1988 Change	Monthly Wage	Average Worker Age (years)	Number of Firms
Communications	Y10,359	4.51%	Y12,874	5.37%	Y238,129	36.6	41
Leisure	9,262	4.05	11,763	5.03	232,723	34.3	77
Retailing	8,055	3.99	10,368	5.01	205,133	30.1	48
Information, Software	10,502	4.26	12,307	5.00	243,699	32.4	36
Electronics	7,439	3.59	9,801	4.58	213,534	33.2	90
Real Estate	8,850	3.66	11,011	4.49	247,624	36.8	125
Machine Tools	7,859	3.43	10,446	4.47	232,900	34.4	184
Securities	7,440	3.90	8,700	4.46	195,226	26.4	2
Distribution, Transport, other services	8,259	3.46	10,800	4.41	244,982	37.9	88
Food, Pharmaceuticals	8,234	3.54	10,021	4.22	238,207	34.9	125
Automotive	6,940	3.25	9,106	4.16	218,936	34.4	114
Energy, Metals, Chemicals, Raw Materials	6,987	3.01	8,975	3.83	235,415	35.6	280
Aerospace, Engineering	5,821	2.48	7,824	32.8	239,535	38.8	100
Average	7,936	3.50	10,162	4.38	231,750	35.2	1,310

Source: Nihon Keizai Shimbun, May 4, 1988.

Nevertheless, the survey is a good indicator of the relative health of the various industries. It is clear that workers in service industries enjoyed

significantly larger pay raises than their counterparts in manufacturing firms, with communications, leisure, retailing, and software and information services leading the way. At the other end of the spectrum, steel and shipbuilding workers eked out 1.7 and 2.7 percent pay raises, respectively. While the service sector has indeed been enjoying strong growth, corporate profits for industry as a whole were up 19.3 percent in fiscal 1987 and manufacturing firms showed an even higher average gain of 24.7 percent.

Coupled with a solid outlook for overall economic growth and a falling unemployment rate, labor had hoped for an average 6 to 7 percent increase. Industry leaders responded by reiterating last year's position that wage increases only fuel inflation, and that the best path to increased real income is to lower prices for goods, services and housing through deregulation and tax reform. The 1988 shunto was the first test for the recently formed Japan Private-Sector Trade Union Conference, or Rengo, which represents 5.6 million workers. Hoping for an average 6 percent increase, Rengo's leadership called this year's talks a "harsh trial" but claimed above-average results anyway. That management was able to hold the line reveals the true relative strength of business and labor in Japan.

With overall inflation running around 1 percent, opinion is divided as to the impact on consumption of the 3.4 percent real wage increase. Pointing to solid growth in consumer spending, some analysts predict an overheating, pushing up the consumer price index by as much as 1.5 percent (it has been flat for the past two years). Others point to the close match between wage and productivity growth in arguing that there will be no impact on prices. They also assert, however, that the increase will not spur consumption growth, but only keep it at current levels. At present the threat of inflation is minimal. The wage hikes combined with prospective income tax reductions and fading fears about the adverse impact of the strong yen are expected to encourage consumers not only to spend more but actually to save less.

On the other hand, restrained raises in the manufacturing sector, particularly for the automotive industry, will help Japan maintain its international competitiveness. The rapidity with which exporters have adjusted to the high yen has already shown up in the form of a return to positive growth in the volume of exports. The trend, which will surely be aided by moderate wage hikes, has raised fears in the government that Japan's trade surplus will actually expand in 1988, severely embarrassing Tokyo and exacerbating trade frictions.

The caveat to all this is that final shunto results will not be known until the end of May or early June. Given that there was a significant difference between initial and mid-term surveys (the average increase was initially reported to be 4.45 percent), the final results could show another discrepancy. The wage picture for all Japanese workers is likely to be more disappointing, since non-unionized workers, representing about 70 percent of total employment, generally receive increases 1 percent below the union average.

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